The Liability Risk Retention Act: Background, Issues, and Current Legislation

Updated June 24, 2011

Congressional Research Service
https://crsreports.congress.gov
RL32176

Summary

Risk retention groups (RRGs) and risk purchasing groups (RPGs) are alternative insurance entities authorized by Congress to expand insurance supply through a simplification of insurance regulation. The McCarran-Ferguson Act of 1945 generally leaves the regulation and taxation of the business of insurance to the individual states. In 1981 and 1986, however, Congress crafted a narrow exception to the usual state insurance regulations for these groups, generally exempting them from multiple state oversight. Membership in risk retention and purchasing groups is limited to commercial enterprises and governmental bodies, and the risks insured by these groups are limited to liability risks.

Over the past two decades, interest—both in Congress and in the market—in RRGs and RPGs has varied largely with the vagaries of the regular insurance market. From 2001 to 2004, the insurance market was in one of its periodic "hard" markets, and regular insurance became increasingly expensive and sometimes unavailable. Since 2001, the numbers of risk retention groups rose dramatically and calls have been heard to expand the scope of insurance that they are allowed to offer. At the same time, some problems occurred in individual risk retention groups, and cautionary voices have also been raised. Although the liability insurance market has softened somewhat in the past few years, with policies becoming more available and relatively less expensive, risk retention groups have continued to form in significant numbers.

The fundamental question surrounding expansion of the Liability Risk Retention Act (LRRA) can be posed as an issue of availability vs. reliability. Those who would support expansion often emphasize a failure of the current insurance market and the current regulatory system to make a sufficient supply of insurance available so that consumers who need insurance can find it at a reasonable price. The question they pose is essentially: "What happens to a community when a business, a school, or a doctor can not afford or find liability insurance?" Those who would oppose expansion often emphasize the dangers in allowing insurance to be sold that is not subject to same regulatory standards as "normal" insurance. The question this group poses is essentially: "What happens to a community if the insurer from which this business, school, or doctor purchases insurance ends up insolvent or if the policy does not cover what needs to be covered?"

In the 112th Congress, H.R. 2126, the Risk Retention Modernization Act of 2011, would extend the LRRA to commercial property insurance, authorize the Federal Insurance Office to determine the states' compliance with the act and impose corporate governance standards on RRGs and RPGs. Representative John Campbell introduced the bill on June 3, 2011. A similar bill was introduced in the 111th Congress by Representative Dennis Moore, with Representative Campbell as a cosponsor.

This report outlines the current regulatory structures affecting risk retention and risk purchasing groups as well as the legislative and market history of these groups. It also discusses the debate regarding possible expansion of these groups into areas beyond commercial liability insurance. This report will be updated as significant legislative events occur.

Contents

Tables

Appendixes

Contacts

Introduction

The insurance industry, particularly property/casualty insurance,[1] is known for alternating periods of "hard" and "soft" markets. Turns in this cycle are typically traced to unexpected changes in the investment climate, unexpected changes in insurance payouts, or both. During a typical hard market, the supply of insurance goes down, insurance prices go up, and underwriting standards become more stringent. This often leads to consumers encountering difficulty in finding and affording insurance. During a soft market, prices are typically flat, and insurers are more willing to underwrite greater risks, so consumers typically do not face such problems in obtaining insurance. Legislative attention tends to focus on insurance matters during hard markets as constituents relate complaints about finding or affording insurance to their legislators. Because regulation of the insurance market was left to the states in the McCarran-Ferguson Act of 1945,[2] however, the legislature in question is most often a state legislature. Among the solutions offered at the state level has been the creation of, or allowance for, "alternative" market entities to increase the amount of insurance available to consumers. The alternative market is made up of entities or arrangements that spread and finance risk like an insurance company, but that operate outside the normal regulations governing the world of "regular" insurance companies.[3]

In 1981, Congress authorized the creation of alternative market entities known as risk retention groups and risk purchasing groups (RRGs and RPGs). Their purpose was to expand insurance supply by simplifying state insurance regulation. In the 1981 act, subsequently amended in 1986 and known now as the Liability Risk Retention Act[4] (LRRA), Congress crafted a narrow exception to the usual state insurance regulations for these groups in largely exempting the groups from multiple state regulation. Over the past few years, interest in risk retention and purchasing groups has increased as access to affordable insurance has become a challenge for some businesses. Some have suggested that Congress needs to expand the narrow exception that was made in the 1980s in order to expand the supply of insurance in areas outside of the liability coverage allowed under the current law. Legislation was introduced in both the 110th and 111th Congresses to expand the LRRA to commercial property insurance, but no action was take on these bills. Such legislation (H.R. 2126) was introduced again in the 112th Congress by Representative John Campbell.

Recent Legislation

112th Congress

Risk Retention Modernization Act of 2011 (H.R. 2126)

H.R. 2126 was introduced by Representatives John Campbell, along with Representative Peter Welch, on June 3, 2011. It has been referred to the House Committee on Financial Services.

[1] The insurance industry is typically broken down into life/health and property/casualty insurance. Life/health is relatively straightforward, following its name, and also includes annuity products. Property/casualty is a more diverse group, including auto, homeowners, professional liability, and many others. Property/casualty essentially refers to everything that is not life or health insurance.

[2] 15 U.S.C. §§ 1011 *et seq*, P.L. 79-15, 59 Stat. 33.

[3] See Insurance Information Institute, "Captives and Other Risk-Financing Options," at http://www.iii.org/media/hottopics/insurance/test3.

[4] 15 U.S.C. §§ 3901-3906, created by P.L. 97-45 and P.L. 99-563.

This bill would expand the federal preemption of state insurance laws, allowing risk retention groups to cover commercial property risks and risk purchasing groups to purchase coverage for commercial property risks. The bill would also change the enforcement mechanism for federal preemptions in the LRRA, and add additional federal corporate governance, disclosure, and fiduciary duty requirements for risk retention groups under the act.

Under existing law, the federal preemptions in the LRRA are enforced through court action. If a risk retention group believes a state is attempting to regulate in a manner counter to the LRRA, it can bring suit in a federal court. H.R. 2126 would create a process under which the director of the Federal Insurance Office could issue determinations as to whether a state's regulation of an RRG or RPG is preempted by the act. In addition, the director is to study and issue reports to Congress on the states' regulation of RRGs and RPGs and the compliance with the LRRA.

The corporate governance standards to be issued by the director of the Federal Insurance Office by the bill would include requirements that a majority of directors on an RRG's board be independent, any audit committee be made up of independent directors, written governance standards be in place, and contracts with service providers be limited to less than five years and be approved by the state insurance commissioner. Additional specific amendments to the LRRA would expand the consumer disclosure required in the act and impose a fiduciary duty on the board of directors of a risk retention group.

111th Congress

Risk Retention Modernization Act of 2010 (H.R. 4802)

H.R. 4802 was introduced by Representative Dennis Moore (along with Representatives John Campbell and Suzanne Kosmas) on March 10, 2010. It was referred to the House Committee on Financial Services but was not acted upon further. This bill was essentially similar to H.R. 2126 as introduced in the 112th Congress (detailed above). Differences include the replacement of the "Secretary of the Treasury" in H.R. 4802 with the "Director of the Federal Insurance Office"[5] as the primary federal official tasked with overseeing state compliance with federal law and the deletion of a section in H.R. 4802 calling for an study by the Comptroller General of the United States.

The sponsors of H.R. 4802, through a separate July 22, 2010, letter to the Comptroller General, requested that the Government Accountability Office (GAO) conduct a study similar to the one required in H.R. 4802. According to Representative Moore's office, GAO indicated that such a study would be conducted, but it is unclear when the results may be issued.

110th Congress

Increasing Insurance Coverage Options for Consumers Act of 2008 (H.R. 5792)

H.R. 5792 was introduced by Representative Dennis Moore (along with Representatives Deborah Price, John Campbell, and Ron Klein) on April 15, 2008. It was addressed in an April 16 hearing "Examining Proposals on Insurance Regulatory Reform" held by the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises. The bill was marked up by this subcommittee on July 9, 2008, and forwarded to the full committee, but it was not acted on further in the 110th Congress.

[5] The Federal Insurance Office was not in existence when H.R. 4802 was introduced.

H.R. 5792 would have expanded the LRRA exemptions to commercial property insurance. In addition, the bill would have implemented a number of corporate governance standards for RRGs, including requiring a majority of independent directors on an RRG's board, requiring an audit committee made up of independent directors, requiring a written charter, and limiting longer-term contracts with service providers. The bill would also have required all RRGs offering property coverage to be U.S.-licensed insurance companies.[6]

Risk Retention and Purchasing Group Structure and Regulation

Risk retention groups are required by current federal law[7] to be state-chartered insurance companies; they are allowed to insure commercial liability risks, such as the risk that a physician will be found liable for medical malpractice, but not other property/casualty risks, such as the risk that a physician's office might burn down. These insurance companies also must be owned by the members of the group. All policies issued by a risk retention group must bear a federally mandated warning that the policy is not regulated or guaranteed in the same way as other insurance. Group members are required to be businesses, including individual professionals such as physicians and attorneys, or government entities, such as public universities, school districts, and town or city administrations, who are engaged in a similar business or face similar risks. The exact corporate structure of a risk retention group can vary. Many are licensed as "captive" insurers,[8] which may have lower capital requirements, but some are licensed as "regular" mutual insurers. Risk purchasing groups are likewise groups of entities in a similar business or facing similar risks. Instead of creating their own insurance company, these groups join together to purchase commercial insurance from established insurance companies.

If risk retention groups must be licensed as an insurer under the existing laws of an individual state, two questions arise: What advantages do they possess? Why go to the trouble and expense of creating such a group? The answers are in the different regulatory treatment of these groups as they operate outside of the state where they are chartered (or "domiciled"). Under normal circumstances, an insurer who wishes to operate outside of its domiciliary state must receive a license and submit to regulation from every state in which it wishes to do business. This means complying with up to 51 different sets of state or district laws and regulations in order to do business across the country. The impact of this multiplicity of regulation is particularly high in insurance, as compared with other businesses, because both the prices and the content of insurance policies are highly regulated in most states. This perceived burden of multiple state regulatory systems is also the primary argument cited currently by some in the insurance industry for creating a federal charter to replace or supplement the current state system.[9]

Risk retention groups are exempted by federal law from the requirement to be licensed in all states in which they operate as well as from other state laws regulating the business of insurance.

[6] The 1981 Risk Retention Act allowed offshore risk retention groups. The 1986 amendments required RRGs be domiciled in the United States, but grandfathered the small number of then-existing offshore RRGs.

[7] 15 U.S.C. 3901 *et seq*.

[8] Captive insurers are "Insurers that are created and wholly owned by one or more non-insurers, to provide owners with coverage. A form of self-insurance." From the Insurance Information Institute's online glossary available http://www2.iii.org/glossary/c/. See also http://www.captive.com. Captives are typically licensed as insurers either in an individual state or offshore, often in Bermuda or the Cayman Islands.

[9] For more information on the federal chartering issue, see CRS Report RL34286, *Insurance Regulation: Federal Charter Legislation*, by Baird Webel.

They must register and file documentation with a state's insurance regulator, but after this filing, they are essentially free to do business in that state. This exemption from state law extends to most laws on the business of insurance, but laws such as those on fraudulent trade practices, nondiscrimination, and unfair claim settlement practices still apply. Risk retention groups must also pay state premium taxes as regular insurers do. In addition, a non-domiciliary state's insurance regulator is empowered to monitor the financial solvency of a group, including requiring that a group submit to a financial condition examination if the chartering state regulator refuses to do such an exam, and seeking an injunction to force it to cease doing business if the group is in hazardous financial condition. This regulatory oversight is less than that accorded regular insurance companies, however, and some observers fear that this might lead to an increased danger of such groups becoming insolvent. In the case of a risk retention group insolvency, the policyholders have no recourse to a state guaranty fund because membership in these funds is specifically prohibited by the federal statute.

Risk purchasing groups are given a similar, but more limited, exemption from state law. Many states have laws, known as "fictitious grouping laws," that specifically prohibit or limit groups from purchasing insurance for the members of the group, particularly if the group exists solely for the purchase of insurance. State insurance regulators use these laws to protect consumers and ensure solvency. Risk purchasing groups are exempted from these laws and from countersignature laws, which are laws requiring a local broker's or agent's signature on an insurance contract. The insurance that such groups purchase on behalf of their members must meet the laws and regulations of the state that is designated as the domicile of that group.

Legislative History

The 1981 Product Liability Risk Retention Act

The first "Product Liability Risk Retention Act" was introduced in 1979, and an amended version became P.L. 97-45 in 1981. Its origin can be traced to an interagency task force created by the White House in 1975[10] to examine difficulties in the availability of product liability insurance. Among the proposals discussed by the task force's report was the possible creation of alternatives to the traditional insurance market. The 1981 act was relatively narrow, limiting risk retention groups and risk purchasing groups to insurance covering product liability[11] as well as completed operations liability.[12] The 1981 act also limited members of these groups to "product manufacturers, wholesalers, distributors and retailers."[13] Risk retention groups had to be chartered, and thus regulated, as an insurer in one of the United States or U.S. jurisdictions, or in Bermuda or the Cayman Islands.[14] The act specifically exempted risk retention groups from most

[10] Interagency Task Force on Product Liability. Its final report was published by the Department of Commerce in 1977 (NTIS PB-273-320).

[11] "Products liability refers to the liability of a manufacturer or seller for injury caused by his product to the person or property of a buyer or third party." See CRS Report R40148, *Products Liability: A Legal Overview*, by Vivian S. Chu for additional discussion.

[12] Completed operations liability insurance generally covers claims arising after the completion of a project (for example, if a contractor finished a house, but a defect was found some time later).

[13] U.S. Congress, Senate Committee on Commerce, Science, and Transportation, *Product Liability Risk Retention Act of 1981*, report to accompany S. 1096, 97th Cong., 1st sess., S.Rept. 97-102 (Washington, GPO, 1981), p. 1; and U.S. Congress, House Committee on Energy and Commerce, *Product Liability Risk Retention Act of 1981*, report to accompany H.R. 2120, 97th Cong., 1st sess., H.Rept. 97-190 (Washington, GPO, 1981), p. 7.

[14] The authority to form risk retention groups outside of the United States was limited in time, expiring on January 1, 1985.

regulation by any state in which they operate, aside from the chartering state. This federal exemption, however, did not cover laws that were not specific to the business of insurance, such as fraud or deceptive practice laws. The act also preempted any state laws preventing risk purchasing groups from purchasing the same narrow range of insurance as that allowed to be offered by risk retention groups.

By the time the act became law in September 1981, the liability market difficulties that prompted so much attention had largely passed. With regular commercial insurance available and relatively inexpensive, there was little incentive for companies to undertake the expense of forming risk retention or purchasing groups, and only three of the former and four of the latter were formed in the first four years of the act's operation.

Despite the lack of market action, congressional interest in the issue continued. In 1983, a Clarification of the Risk Retention Act (S. 1046, eventually P.L. 98-193) was passed by voice votes of both the House and the Senate. This act was a response to a model state law promulgated by the National Association of Insurance Commissioners (NAIC).[15] This model law referenced the various state tort laws in its definition of "product liability" rather than following the definition passed by Congress in the 1981 act. The state tort laws tended to have a more narrow definition than that desired by Congress. P.L. 98-193 specified clearly that the definitions in the federal statute would be the controlling definitions for purposes of the Risk Retention Act.[16]

The 1986 Liability Risk Retention Act

In the mid-1980s, the insurance market began to harden again and Congress again heard of many problems faced by businesses and individuals in finding and affording insurance. One of the congressional responses was to reconsider the 1981 act. Numerous bills were introduced to expand the provisions so that more consumers might avail themselves of the additional insurance supply mechanism that Congress had created.

Congress ultimately passed S. 2129 (eventually P.L. 99-563), which renamed the 1981 act the "Liability Risk Retention Act" and brought the law to its present form. P.L. 99-563 expanded the scope of the insurance to include most types of commercial liability insurance and expanded the organizations that could form such groups to include any business as well as state or local governments or governmental entities as long as all the members of a single group were engaged in similar business activities or were exposed to similar risks. This expansion, however, did not retroactively include the small number of foreign-based risk retention groups. These groups, formed under the temporary authority described above, were allowed to continue in the area of product liability insurance but were not permitted to expand into other kinds of commercial liability insurance. P.L. 99-563 also included changes designed to allow some increased oversight of risk retention and purchasing groups, including the requirement to file documentation in non-chartering states, and the right of non-chartering commissioners to conduct examinations if the chartering state fails to do so and to seek injunctions against groups in a hazardous financial situation. In general, however, the intent of Congress remained to allow these groups to operate throughout the country while being regulated largely, if not solely, by a single state regulator, rather than facing 51 jurisdictions with different laws and regulatory styles.

---

[15] The NAIC is the national trade association of state insurance regulators, which, among other activities, publishes model laws to encourage harmonization of state insurance regulation.

[16] For more discussion, see U.S. Congress, Senate Committee on Commerce, Science, and Technology, *Clarification of the Risk Retention Act*, report to accompany S. 1046, 98th Cong., 1st sess., S.Rept. 98-172 (Washington, GPO, 1983).

RRGs and RPGs Since 1986

Growth in the Risk Retention Market[17]

Market reaction to the expansion of the law was relatively swift. By 1988, 52 risk retention groups had been created with more than 24,000 insured and a total premium amount of $250 million. (See the **Appendix** for a table containing complete risk retention group statistics) The number climbed to 79 in 1991 and then plateaued for the next 10 years, actually declining to 72 in 2001. The number of insureds and the total premium amount, however, continued to increase, reaching over 172,000 insureds and $944 million in premiums in 2001. Within the aggregate statistics, there was significant churning, as individual groups are formed and retired based on the business decisions made by those seeking insurance. In the period from 1987 to 2001, a total of 142 risk retention groups were formed and 73 retired. Reasons for a group retirement vary greatly. Some became insolvent, some changed status to become a regular insurer or were absorbed by a regular insurer, and some simply ceased operation when insurance on the regular market became more affordable.[18]

The relative calm in the marketplace that prevailed through the 1990s ended quickly with the hardening of the insurance market in 2001. This hard market has been ascribed to the downturn in both interest rates and the stock market as well as to unexpected losses, particularly the approximately $35 billion in insured losses due to the terrorist attacks on September 11, 2001. Making many of the price increases even more dramatic after 2001 was the prolonged soft market of the 1990s, which led to underpricing by insurers and some complacency on the part of the insured policyholders.

Interest in risk retention groups increased along with the prices of insurance and reinsurance. The number of RRGs and premiums increased fairly steadily from 72 groups and $994 million in premium in 2001 to 245 groups and $2.6 billion in premiums in 2006. The number of RRG insureds, however, did not follow the same pattern. The insureds numbered 172,713 in 2001, declining to 139,837 in 2002, before growing to nearly 218,000 in 2006. (This decline in insureds was due particularly to insolvencies in RRGs discussed below.)

Risk retention group growth during the hard market of the early 2000s occurred particularly in the health care arena. In the 2004 survey, for example, 28 of the 41 new groups were insuring some form of health care liability. In the 2007 study, the comparable number was 34 of 52 new RRGs. Within health care, nursing homes showed the largest growth, going from zero nursing home RRGs in 2002 to 20 at the end of 2005.[19] The growth in health care RRGs seemed largely due to widely reported difficulties that health care providers were encountering in obtaining medical malpractice insurance. In one interesting case, a Pennsylvania Department of Public Welfare grant reportedly provided the initial $5 million in capital for a Vermont-domiciled risk retention group with the purpose of insuring nursing homes solely in Pennsylvania.[20] Apparently, this

[17] Except where noted, statistics in the section taken from successive annual surveys done by the *Risk Retention Reporter* (Pasadena, CA; http://rrr.com/).

[18] See "Soft Market Fueled Risk Retention Group Retirements During 1990s," *Risk Retention Reporter*, February 2002.

[19] "Premium Generated By Healthcare RRGs More Than Triples Since 2001," *Risk Retention Reporter*, December 2002.

[20] Andrew Sargeant, USA Risk Group of Vermont, as quoted in "Sources of Capital for Risk Retention Groups," *Risk Retention Reporter*, June, 2003.

occurred because the chartering laws on the creation of smaller or captive insurers in Vermont were preferred to those in Pennsylvania.

The liability insurance market generally has softened since 2005 or so.[21] For 2010, risk retention group premiums are estimated to have been approximately $2.7 billion, with 262 groups in operation and more than 272,000 insureds.[22]

Individual Difficulties Have Come Along with Growth

The growth of risk retention groups has not been without some problems. As was noted above, the number of insured declined from 2001 to 2004. This was largely due to the liquidation of three Tennessee-domiciled groups[23] that insured physicians, lawyers, and other professionals for professional liability. The liquidation was forced by the insolvency of a regular Virginia-based insurer who had provided reinsurance for these risk retention groups. Individual policyholders of regular insurance are normally eligible for protection in the case of insurer insolvency under the various states' guaranty funds; this, however, would typically apply only to those directly insured by the Virginia company, not to policyholders of companies that are reinsured by this company. These policyholders are considered creditors of the company, not insureds, and thus have a lower priority claim on the assets of the failed company. Further complicating the legal situation is the statutory prohibition on risk retention group participation in state guaranty funds. Class action lawsuits[24] were filed by insureds seeking guaranty fund protection for the insured along with damages for other malfeasance.[25]

Another risk retention group failure that has attracted considerable attention is the insolvency of the National Warranty Insurance Risk Retention Group (hereafter "National Warranty"). Although physically headquartered in Lincoln, Nebraska, National Warranty was incorporated in the Cayman Islands. It was one of a handful of RRGs that were incorporated outside of the United States before 1985 and was thus grandfathered out of regulation by any of the individual states. Prior to its being declared insolvent in August 2003, it acted as an insurer of the obligations taken on by its members, mainly marketing companies and auto dealerships, who sold vehicle service contracts. Although the actual group was made up of only approximately 580 members, the potential effect of the insolvency is more widespread, as these members sold contracts to or through more than 5,000 auto dealerships in 49 states.[26]

[21] Some other insurance markets, particularly the property insurance market in states threatened by hurricanes, have significantly hardened in the past few years. This has prompted Congress to explore other avenues to expand insurance supply, such as The Homeowners' Defense Act of 2009 (S. 505/H.R. 2555 in the 111th Congress). See CRS Report R40680, *Financing Catastrophic Risk: Summary of the Homeowners' Defense Act of 2009 (S. 505 and H.R. 2555)*, by Rawle O. King.

[22] "Premium and Number of RRGs by Business Area," *The Risk Retention Reporter*, October 2010.

[23] These groups were the American National Lawyers Insurance Reciprocal, Doctors Insurance Reciprocal Risk Retention Group, and The Reciprocal Alliance.

[24] Fullen v. General Reinsurance Corp., et al. (VLW 003-12-03), Herrick v. General Reinsurance Corp., et al. (VLW 003-12-01), and Crenshaw Community Hospital v. General Reinsurance Corp., et al. (VLW 003-12-02). See "Class-Action Suits Filed Against Reciprocal Companies," Virginia Lawyers Weekly, April 3, 2003, available at http://www.valawyersweekly.com/anlir14.cfm. These three suits were subsequently consolidated in the United States District Court for the Middle District of Tennessee (Memphis) as In re Reciprocal of America (ROA) Sales Practices Litigation (MDL No. 1551).

[25] For a more complete reporting, see "Policyholders of Reinsurance Group Reciprocal to Get Partial Payment," *Richmond Times-Dispatch*, October 20, 2003, and "Move to Liquidate ROA Will Impact RRG Insureds and Others," *Risk Retention Reporter*, May 2003, as well as the previously cited article in *Virginia Lawyers Weekly*.

[26] Figures from John Taylor, "Irate Consumers File Class-Action Suit against Lincoln, Neb., Firm," *Omaha World-*

The text of the LRRA requires insureds to be members and part owners of a risk retention group; however, this line was apparently somewhat blurred in the National Warranty case. National Warranty acted both as an administrator, adjusting claims on behalf of its members, and as the insurer of these members.[27] This dual role apparently gave the impression that the final consumers were purchasing service contracts directly from National Warranty rather than from the individual group members. The National Warranty liquidation process is still ongoing.[28]

Policy Issues and Considerations

For several years, interest groups have made a concerted effort, including the formation of a Council for Expanding the Risk Retention Act, to advocate expanding the provisions of the Risk Retention Act to include commercial property and casualty insurance, except for workers' compensation insurance. In 2002, the National Conference of Insurance Legislators (NCOIL) approved a resolution supporting such an expansion, and a major consumer group, the Consumer Federation of America, has written in support of the idea as well.[29] Some insurance regulators, for example, then-District of Columbia Commissioner Lawrence Mirel and then-Vermont Director of Captive Insurance Leonard Crouse, also previously expressed their support for expansion of the Risk Retention Act.[30]

Doubts about such an expansion, however, have also been raised. In National Association of Insurance Commissioners (NAIC) meetings, a prominent doubter was former Nebraska's insurance director, Tim Wagner, who was at the forefront of dealing with the National Warranty insolvency. At the September 2003 meeting, the NAIC was encouraged to adopt a draft resolution that would put the group on record as opposing the expansion of risk retention groups.[31] Among the reasons cited in the resolution was the danger to consumers from a limitation on states' regulatory authority, the example of the National Warranty failure, and the absence of an availability problem in property insurance that has not been addressed by state-based solutions. No resolution has been adopted, but a "Risk Retention Working Group" to examine issues surrounding risk retention groups was created. Among other actions, this group has proposed corporate governance standards for RRGs.[32] The U.S. Government Accountability Office also discussed problems in risk retention groups in a 2005 report entitled *Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed*.[33]

The fundamental questions surrounding LRRA expansion are essentially the same as those addressed by Congress when the first act was passed in 1981, and when it was expanded in 1986. Stripping away jargon, this question can be phrased as an issue of availability vs. reliability. Arguments in support of expansion often focus on a failure of the current insurance market, and

Herald, September 23, 2003.

[27] Caroline McDonald, "Lessons from National Warranty," *National Underwriter, Property & Casualty/Risk & Benefits Management Edition*, October 24, 2003.

[28] See the company website at http://www.nwig.com.

[29] See Consumer Federation of America, *Creating Insurance Alternatives to Bring Down Rates*, at http://www.consumerfed.org/pdfs/risk_retention_act-expansion.PDF.

[30] Lawrence Mirel, letter To Whom It May Concern, September 16, 2002, and Leonard Crouse, letter To Whom It May Concern, May 15, 2002.

[31] Meg Fletcher, "NAIC May Seek to Block RRG Expansion," *BI Daily News*, September 18, 2003, at http://www.businessinsurance.com/cgi-bin/news.pl?newsId=2894.

[32] The NAIC Risk Retention Group Task Force's recent activities can be found on the NAIC website at http://www.naic.org/committees_e_risk_retention_group_tf.htm.

[33] U.S. Government Accountability Office, *Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed*, GAO-05-536, August 2005, available at http://www.gao.gov/new.items/d05536.pdf.

the current regulatory system, to make a sufficient supply of insurance available so that consumers who need insurance can find it at a reasonable price. The question posed is essentially: "What happens to a community when a business, a school, or a doctor cannot find or afford insurance?" Arguments opposing expansion often focus on the dangers in allowing insurance to be sold that is not subject to same regulatory standards as "normal" insurance. The question posed is essentially: "What happens to a community if the insurer from which this business, school, or doctor purchases insurance ends up bankrupt or if the policy does not cover what needs to be covered?" The underlying basis for this question with regard to risk retention groups seems to be the assumption that the single domiciliary state regulator will do an insufficient job in protecting the consumers who live in other states. Recent legislation in Congress has addressed some concerns raised in the past about the "reliability" of risk retention groups through the provisions addressing corporate governance structures and disclosure.

Secondary arguments are also made. Because the insured are the owners of a risk retention group, it could be argued that they can see to it themselves that the insurance provided is reliable. It is also argued that the rates of failure of regular insurers and risk retention groups are nearly the same, and that the failure of National Warranty was a unique situation since it was an offshore group that was unaccountable to any state regulator. Doubters may counter by questioning what sort of impact risk retention groups might have when, even with their recent growth, they still occupy a fraction of a percent of the property/casualty market. In addition, even if the failure rates are similar, the impact of a state-regulated insurer failure is likely to be mitigated by its participation in state guaranty funds, which are specifically unavailable to insurers operating under the Liability Risk Retention Act.

Assessing the arguments on either side is a challenge for Congress. The broad question of availability vs. reliability can be framed by some as a basic philosophical question about the degree of regulation needed by insurance markets and may not have an absolute empirical answer. Some see insurance philosophically as a public good, akin to a basic utility, and one that must be highly regulated in price and content to protect consumers. Others do not share this philosophy and feel insurance should be lightly regulated, with the market determining prices and content. In general, the states, who have faced such basic insurance regulatory questions for many years, have attempted to suit the amount of regulation to the perceived sophistication of the consumer. Thus, the market for commercial insurance is usually left relatively less regulated on the theory that the businesses purchasing in the commercial market have the knowledge and experience to discern the intricacies of insurance policies and companies, or at least hire professionals to make these "reliability" judgments for them. Individual consumers are presumed to be less well placed to make these judgments; thus, the market for such insurance, particularly homeowners and auto, tends to be more regulated. Internationally, the insurance markets in general have tended to be less regulated, particularly with regard to the direct price and content controls found in some of the United States.[34]

The differential regulatory approach based on the sophistication of the consumer can be seen, for example, in the operation of state guaranty funds. These funds are intended to step in and pay claims arising from insolvent insurers, but they typically have a relatively low cap on the amount that can be paid to each policyholder. Keeping this amount low implies that consumers with relatively low claims, presumably most individuals, will be nearly fully protected against loss, while consumers with relatively high claims, presumably larger businesses, will be only partially protected. This cap on guaranty fund claims also affects the direct arguments surrounding risk retention groups. Because most risk retention group members, as businesses, face potentially

[34] For a more in-depth discussion of insurance regulation, see CRS Report R40771, *Insurance Regulation: Issues, Background, and Legislation in the 111th Congress*, by Baird Webel.

large claims, the value of guaranty fund protection will be less to them than to individuals with presumably lower claims.

In assessing some of the more factual arguments, it is true that risk retention and purchasing groups occupy a small part of the insurance market. The approximately $422 billion[35] total premium written in the property/casualty market in 2009 was many times the approximately $2.5 billion in risk retention group premium. Economic theory suggests, however, that it is not necessary for a competitor to have a large market share in order to have an impact on prices or availability. Anecdotal cases, particularly ones such as the Pennsylvania nursing home risk retention group mentioned above, also suggest that the act is expanding the availability of insurance, especially in local situations with severe supply difficulties. The Department of Commerce came to the conclusion in 1989 that the 1986 act had been successful in addressing supply problems,[36] and the GAO made similar findings in the previously mentioned 2005 report.[37]

An assessment of risk retention and purchasing groups also may offer insight into wider questions involving the federal role in insurance regulation. Particularly since the passage of 1999's Gramm-Leach-Bliley Act,[38] some have advocated for an increased federal role in insurance regulation, up to complete federalization of regulation for all interstate insurers. Others have suggested some lesser federal role to address specific problems they see caused by the multiplicity of state regulators, such as slow approval times for products and overly burdensome rate or form regulation. The recent Dodd-Frank Wall Street Reform and Consumer Protection Act[39] includes some insurance provisions, but the debate over the federal role in insurance is expected to continue in the future.[40] The two Risk Retention Acts are an example of one way previous Congresses have tried to solve supply problems arising from, or exacerbated by, the insurance regulatory system. The answer provided by these acts was essentially a system of enforced mutual state recognition without broad federal regulation of insurance. As such an example, these acts might provide some insight into how Congress considers addressing problems in the insurance regulatory system today.

[35] See the Insurance Information Institute website at http://www2.iii.org/financial/insurance/allsectors.

[36] See U.S. Department of Commerce, *Liability Risk Retention Act of 1986: Operations Report 1989*, NTIS PB 90-123134.

[37] "RRGs have had a small but important effect in increasing the availability and affordability of commercial liability insurance for certain groups." U.S. Government Accountability Office, *Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed*, GAO-05-536, August 2005, p. 5.

[38] P.L. 106-102, 113 Stat. 1338.

[39] P.L. 111-203; see also CRS Report R41372, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Insurance Provisions*, by Baird Webel.

[40] See, for example "Frank: Federal Charter Debate on Tap in 2011," *BestWire*, July 8, 2010.

Appendix. Risk Retention Groups Statistics

Table A-1. Risk Retention Groups, 1988-2010

Year	Number of RRGs	Premium Total (millions of $)	Number of Insureds
1988	52	$250.2	24,424
1989	66	$393.4	31,219
1990	76	$452.8	47,857
1991	79	$493.6	46,789
1992	80	$493.7	53,088
1993	85	$527.2	48,849
1994	84	$585.3	63,978
1995	78	$575.5	64,211
1996	73	$707.6	119,269
1997	74	$751.9	150,802
1998	73	$764.4	158,851
1999	73	$769.5	163,235
2000	69	$802.8	165,120
2001	72	$944.0	172,713
2002	90	$1,265.1	139,837
2003	148	$1,737.7	145,582
2004	195	$2,197.7	154,845
2005	219	$2,449.1	197,420
2006	245	$2,638.6	217,924
2007	265	$2,559.1	226,879
2008	272	$2,575.0	238,112
2009	270	$2,638.4	257,720
2010 (projected)	261	$2,683.2	272,223

Source: Annual Surveys by the *Risk Retention Reporter*.

Author Information

Baird Webel
Specialist in Financial Economics

Disclaimer